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No. 07-494

IN THE

Supreme Court of the United States

TIMOTHY J. RIGAS AND JOHN J. RIGAS,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONERS

PETER FLEMING, JR.
BENARD PREZIOSI, JR.
CURTIS MALLET-PREVOST
COLT & MOSLE LLP
101 Park Avenue
New York, N.Y. 10178
(212) 696-6008

- and -

PAUL SHECHTMAN
STILLMAN FRIEDMAN AND SHECHTMAN
425 Park Avenue
New York, N.Y. 10022
(212) 223-0200

Attorneys for John J. Rigas

JOHN W. NIELDS, JR.
Counsel of Record
JOHN F. STANTON
HOWREY LLP
1299 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 783-0800

Attorneys for Petitioner Timothy J. Rigas

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1. The Issue Raised in the Petition is Squarely Presented in This Case

The government's Opposition boldly asserts that the co-borrowing fraud allegations in this case "did not depend on whether the accounting and disclosure complied with GAAP." *See* Cert. Opp. at 16.[1] One reads the Government's entire Opposition, however, without ever learning what co-borrowing fraud was charged in the Indictment, or what FAS-5 says. Not surprisingly then, one does not learn from the Opposition whether a written rule of GAAP governs any issue in this case.

The important fraud alleged in the Indictment deals exclusively with co-borrowings. It charges (i) that the Rigases misrepresented Adelphia's liabilities by failing to carry the RFEs' share of the co-borrowing debt as a liability on Adelphia's balance sheet; and (ii) that they failed properly to disclose the RFEs' share of this debt in financial statement footnotes, "pursuant to GAAP." *See* Pet. at 14; Indictment ¶¶ 64-72 (Pet. App. at 104a-107a).

These accounting issues are governed by FAS-5. Adelphia was contingently liable for the RFEs' share of the co-borrowings, and FAS-5 provides that contingent debt need be carried as a liability by a company only if it is "probable" that the company will have to pay it. Pet. at 23-24. It also provides

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[1] *See* Brief for the United States in Opposition ("Opposition" or "Cert. Opp.").

the rules for when and how contingent debt should be disclosed in footnotes to financial statements. *Id.*

The SEC recently found FAS-5 to be dispositive in a parallel proceeding brought against the DeLoitte partner who approved the manner in which Adelphia accounted for and disclosed the co-borrowed debt. *See In re Dearlove, CPA*, No. 3-12064, Securities Act Rel. No. 57244; Accounting And Auditing Enforcement Rel. No. 2779, 2008 SEC LEXIS 223 (Jan. 31, 2008).

The Commission stated "when an issuer deems itself to be merely contingently liable for a debt, Statement of Accounting Standards No. 5 ("FAS 5") provides the appropriate accounting and reporting treatment for that liability." *Id.* at *38. The Commission then applied FAS 5 and concluded (1) that the allegation that Adelphia had violated GAAP by treating the Rigases' entire co-borrowed debt "as a contingent debt rather than a primary liability on its financial statements" and the allegation that "Adelphia wrongly determined that its chances of having to repay that debt was only remote under FAS 5," were both unproven; but (2) that the footnote disclosure about the co-borrowed debt was inadequate. *Id.* at *48, **58-59.

Of course, neither conclusion is binding in this criminal case which must be decided by a jury on the record developed at trial. However, it is significant that on both issues, the SEC treated FAS-5 as providing the governing standard.

This co-borrowing fraud was by far the most important in the case. It involved an alleged understatement of liabilities in Adelphia's 10K for the year 2000 of $1.5 billion. Indictment ¶ 70 (Pet. App. at 106a). The government began its case with co-borrowing fraud evidence, Tr. 652-53; 813-15; it blamed Adelphia's bankruptcy on it, Tr. 11197-98; it sought and received a special jury instruction based on it, Tr. 11399; and it argued at sentencing that Adelphia's shareholders lost $4 billion because of it. All of this is to say that the Rigas' are serving lengthy prison sentences (20 years for Tim Rigas, and 15 years for John Rigas, who is 83 years old) for an alleged fraud involving an accounting issue governed by a GAAP rule of which the jury never learned.

In short, the government's Opposition essentially ignores the fundamental and nationally significant issue raised by this Petition.

2. The Proposition That FASB's Written Rules are Relevant Only to the Issue of Criminal Intent is Profoundly Wrong

In its Opposition, the Government endorses the decision of the court of appeals that "GAAP rules do not govern" and are relevant only as evidence of good faith. That position is profoundly wrong.

When it comes to the preparation of balance sheets and public financial statements, the FASB makes the rules. It does so pursuant to explicit power that Congress delegated to the SEC and that the SEC delegated to the FASB. Pet. at 21-23. The

Rigases were entitled to have their conduct, in accounting for and disclosing the co-borrowed debt, judged against those rules. They may properly be convicted only if the Government proved and the jury found that they failed to follow those rules. That did not happen here: the Government never called an accounting expert to inform the jury what the rules were, and the jury never decided whether the rules were followed or violated.

The idea that adhering to the established rules is relevant only to the issue of criminal intent is anathema to our criminal law. It is an invitation to lawlessness -- to subjective and inconsistent application of the laws by prosecutors and jurors. Moreover, criminal intent is the intent to do something the law forbids. The jury could not know whether the Rigases acted with criminal intent without knowing what the applicable rules require.

Judge Friendly, speaking for the court of appeals in *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969), had it right. In that case, there were no GAAP rules that addressed the disclosure issue at hand. An accountant sought to defend his conduct in certifying a misleading financial statement by claiming generally that he had not violated GAAP. Judge Friendly rejected that defense saying that compliance with GAAP was not determinative. He limited his opinion, however, to situations in which there are no "specific rules or prohibitions" on point.

In the years immediately following *Simon*, the FASB was created, and it has promulgated a comprehensive series of rules that govern the

preparation of public financial statements. Pet. at 21-23. The decision below ignored the qualifying language in *Simon*. In doing so, it permits criminal prosecutions of corporate executives who follow the rules, so long as prosecutors can persuade a jury that the executives acted with wrongful intent.

That is a dangerous precedent from the court of appeals that decides the lion's share of criminal securities fraud cases in this country.

3. The Cash Management System

The Government devotes part of its Opposition to the Adelphia Cash Management System ("CMS"). Under the CMS, revenues from Adelphia and its subsidiaries were commingled with revenues from the Rigas family owned cable entities which were managed by Adelphia, in return for a management fee. The Government suggests that this commingling gave rise to or misappropriation of funds by the Rigases.

The basic facts are these: First, there was nothing improper about this commingling arrangement, as the government conceded below. Tr. 9062-63. Second, every dollar going into and out of the CMS was meticulously and accurately accounted for. *E.g.*, Tr. 4499-4512, 4614. Running balances were kept for each RFE and each Rigas family member. Third, the CMS was subject to annual audit by DeLoitte, Tr. 4512, 9090-91, resulting in clean audit opinions. Tr. 4512-13; 4821-22; 4945-47; 9769-72. This may explain why the jury acquitted the Rigases on all wire fraud counts -- the

only counts charging them with defrauding *Adelphia* out of money.

In short, to the extent that the government discusses the CMS to suggest to the Court that it, and not the co-borrowing fraud, was the heart of this case, that suggestion is wholly unfounded. The Rigas case centered on allegations of co-borrowing fraud, and the jury *never* was apprised of the controlling GAAP standard.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

PETER FLEMING, JR.
BENARD PREZIOSI, JR.
CURTIS MALLET-PREVOST COLT and MOSLE LLP
101 Park Ave.
New York, N.Y. 10178
(212) 696-6008

-and-

PAUL SHECHTMAN
STILLMAN FRIEDMAN and SHECHTMAN
425 Park Avenue
New York, N.Y. 10022
(212) 223-0200

Attorneys for Petitioner John J. Rigas

JOHN W. NIELDS, JR.
Counsel of Record
JOHN F. STANTON
HOWREY LLP
1299 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 783-0800

Attorneys for Petitioner Timothy J. Rigas

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